84-159

Office - Supreme Court, U.S.
FILED
JUL 30 1984
ALEXANDER L. STEVAS,
CLERK

No.

# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1983

CHARLES JOHNSON,
*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS, NINTH CIRCUIT

ROBERT L. DUNNETT
DUNNETT, BAYS & O'CONNELL
50 University Ave.
Los Gatos, CA 95031
(408) 354-3520
*Attorney for Petitioner*

BOWNE OF SAN FRANCISCO, INC. • 130 NINTH ST. • S.F., CA 94103 • (415) 864-2300

42pp

## QUESTIONS PRESENTED FOR REVIEW

Whether in a federal income tax assessment by the Internal Revenue Service (IRS) based upon an alleged anticipatory assignment of income where an individual taxpayer entered into a contract with a bona-fide, arm's length, unrelated corporation exchanging his exclusive personal services as a professional basketball player for a guaranteed, long-term compensation to bepaid monthly by the corporation and thereafter the corporation licensed his services to National Basketball Association (NBA) teams, and the corporation received compensation for the player's services from the NBA teams,

(1) the taxpayer must have a vested, unrestricted claim to future income at the time he enters into the exclusive personal services contract with the licensing corporation in order for the individual taxpayer to be liable for federal income taxes on the compensation paid by the NBA teams to the licensing corporation;

(2) the individual taxpayer, subsequent to his entering into the contract with the licensing corporation, can execute a contract with the NBA teams without becoming liable for federal income taxes on the payments thereafter made by the NBA teams to the licensing corporation for the individual taxpayer's services.

## TABLE OF CONTENTS


| | Page |
|---|---|
| Questions Presented for Review | i |
| Table of Authorities | iii |
| Opinions Below | 1 |
| Statement of Grounds on Which Jurisdiction of this Court is Invoked | 2 |
| Statutes Involved | 2 |
| Statement of the Case | 2 |
| Reasons for Allowance of the Writ | 5 |
| Conclusion | 14 |
| Appendix A | A- 1 |
| Appendix B | A- 3 |
| Appendix C | A-19 |

## TABLE OF AUTHORITIES

### Cases


| | Page |
|---|---|
| Cold Metal Process Co. v. Commissioner, 247 F.2d 864 (6th Cir. 1957) | 6, 11 |
| Commissioner v. Oates, 207 F.2d 711 (7th Cir. 1953) | 6 |
| Cotlow v. Commissioner, 228 F.Rptr.2d 186 (2nd Cir. 1955) | 10 |
| Estate of Cole v. Commissioner, 32 TCM 1973-74, Dec. 31,909(M) | 7 |
| Foglesong v. Commissioner, 35 TCM 1976-294, Dec. 34,024(M) | 7 |
| Foglesong v. Commissioner, 621 F.2d 865 (7th Cir. 1980) | 11, 12 |
| Fox v. Commissioner, 37 B.T.A. 271 (1938) | 7 |
| Gann v. Commissioner, 31 T.C. 211 (1958) | 8 |
| Gettler v. Commissioner, 34 TCM (1975-87, Dec. 33,124(M) | 7 |
| Harrison v. Schaffner, 312 U.S. 579 (1941) | 6, 11 |
| Johnson v. United States, 698 F.2d 372 (9th Cir. 1982) | 2 |
| Laughton v. Commissioner, 40 B.T.A. 101 (1939) | 7 |
| Lucas v. Earl, 281 U.S. 111 (1930) | 5, 7, 9, 10, 11 |
| Moline Properties v. Commissioner, 319 U.S. 436 (1943) | 7 |
| R. & L., Inc. v. Commissioner, 84 F.2d 721 (5th Cir. 1936) | 12, 13 |
| Rubin v. Commissioner, 460 F.2d 1216 (2nd Cir. 1972) | 7 |
| Shellabarger v. Commissioner, 38 F.2d 566 (7th Cor. 1930) | 13 |
| Teschner v. Commissioner, 38 T.C. 1003 (1962) | 10, 11 |
| Wood Harmon Corporation v. United States, 311 F.2d 918 (2nd Cir. 1963) | 6, 8 |


### Statutes


| | |
|---|---|
| 26 U.S.C. § 6213(a) | 3 |
| 26 U.S.C. § 7442 | 3 |
| 28 U.S.C. § 1254(1) | 2 |
| Int. Rev. Code of 1954, § 61(a) | 2, 7, 8 |

No.

# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1983

CHARLES JOHNSON,
*Petitioner,*

VS.

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS, NINTH CIRCUIT

*To The Honorable Chief Justice of the United States, and to The Associate Justices of the United States Supreme Court:*

Petitioner Charles Johnson files this Petition for Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit which affirmed the judgment of the Trial Court in assessing federal income tax liabilities against Petitioner.

In support of the Petition, it is respectfully shown as follows:

## OPINIONS BELOW

The opinion of the Court of Appeals has not been officially reported. A copy of that opinion is attached as Appendix A.

A copy of the Opinion and Findings of Fact and Conclusions of Law of the trial court is attached as Appendix B.[1]

## STATEMENT OF GROUNDS ON WHICH JURISDICTION OF THIS COURT IS INVOKED

The Memorandum Opinion and order of the Court of Appeals is dated and was filed and entered on April 16, 1984. Petitioner filed a Petition for Rehearing and Suggestion for Rehearing en Banc on April 27, 1984. On May 29, 1984, the Petition for Rehearing was denied and the Suggestion for Rehearing en Banc was rejected. On June 5, 1984, the judgment and order of the Court of Appeals was filed.

Jurisdiction to review the judgment of the Court of Appeals by writ of certiorari is conferred by 28 U.S.C. § 1254(1).

## STATUTES INVOLVED

Int. Rev. Code of 1954, § 61(a):

". . . Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items; . . ."

## STATEMENT OF THE CASE

This action was filed and tried in the Tax Court of the United States to determine the correctness of certain federal income tax deficiencies assessed against Petitioner by the IRS for the years 1975, 1976, and 1977. Jurisdiction is

---

[1]The Opinion of the Court of Appeals stated in part, "This case is essentially similar to a previous case decided by this Court involving the same appellant, *Johnson v. United States*, 698 F.2d 372 (9th Cir. 1982), *reh. and reh. en banc denied* (1983). . . . and the outcome must be the same." Under these circumstances, Petitioner has attached the 1982 *Johnson* case as Appendix C.

conferred upon that Court by 26 U.S.C. § 7442 and 26 U.S.C. § 6213(a). This is a petition for determination of the correctness of the IRS's assessment.

Petitioner is a professional basketball player. He played seven seasons in the NBA, five and one-half seasons with the Golden State Warriors (Warriors), 1972-1977, and one and one-half seasons with the Washington Bullets (Bullets), 1978-1979.

During his first two NBA seasons (1972-73, 1973-74), Petitioner recognized the financial and economic uncertainty which accompanied a career in the NBA. Under the standard NBA player's contract, he was required to "make" the team each September and continue to be on the team for a prescribed period of time (usually through a date in December) in order to be guaranteed payments for the remainder of the season. Payments on these standard contracts typically ran from October through September. If a player was "waived" before playing for the prescribed time, payment for his services ceased.[2]

After examining different ways of obtaining more financial certainty and stability, Petitioner entered into a long-term contract with Presentaciones Musicales, S.A. (PMSA) on or about August 16, 1974. PMSA guaranteed monthly payments to Petitioner for several years in exchange for the exclusive right to license Petitioner's services to professional athletic teams and receive payment for those services from the teams.

From and after August 16, 1974, Petitioner received no payments from the Warriors, the Bullets or any other team

---

[2]Any player performing under a standard NBA contract can be dismissed from the team at any time. The term used by the league is "waiving" a player. After he is placed on waivers, other teams have 48 business hours to accept the player and the contract under which he is performing. If no team accepts the player in 48 hours, he has "cleared waiver" and becomes a free agent.

in the NBA. Petitioner did receive compensation payments under his August 16, 1974 contract with PMSA.

On August 20, 1974, PMSA assigned the contract to Interlit, B.V.I.[3] (Interlit). Thereafter, on August 27, 1974, Petitioner signed a two-year contract with the Warriors. Petitioner later signed an additional Warriors contract and subsequent contracts with the Bullets. The Warriors and the Bullets paid Interlit (PMSA's assignee) for Petitioner's services. Both teams deducted withholding taxes from the payments to Interlit. Said withholding taxes were paid to the IRS and relevant state taxing authorities. Each year a Form W-2 was issued to Petitioner showing the amount withheld for both federal and state income tax purposes. Petitioner paid annual estimated tax payments to the IRS.

Commencing in 1975, and each year thereafter, Petitioner timely filed his federal and state income tax returns and reported the compensation paid to him under the PMSA contract. Each year Petitioner claimed as a refund the withholding tax payments made by the Warriors and Bullets to the IRS as well as the excess of estimated tax payments. Each year these previously-paid taxes would be refunded to Petitioner by federal and state authorities.

Under his long-term PMSA contract, all payments for Petitioner's services were the property of PMSA or its assignee, Interlit. This included the amounts refunded to Petitioner by the IRS and state taxing authorities. Thus, when refunds were received by Petitioner, they were endorsed in each instance to Interlit and paid to Interlit.

The IRS assessed additional income tax liabilities against Petitioner for the years 1975, 1976 and 1977, asserting that he should be taxed on the payments made by the teams

---

[3]At the time of PMSA's assignment, Interlit was known as EST, International. The name of the corporation was changed in 1976. This petition shall use the name Interlit.

acquiring his services to PMSA or its assignee, Interlit. In July, 1979 and July, 1980, Petitioner timely filed petitions with the Tax Court challenging the correctness of the IRS assessments.

The petitions were consolidated and a trial of the matter was held in August, 1981. The Tax Court held that Petitioner should be taxed on the payments made by the NBA teams to the corporation solely because the Court found there was no contract, written, oral or implied, between the NBA teams and PMSA. The Tax Court recognized and accepted Petitioner's prior long-term contract with PMSA and its assignment to Interlit. The Court further acknowledged that when Petitioner entered into the long-term contract on August 16, 1974, he had no vested right to receive any future compensation from the Warriors until he made the team and remained on the team until December 2 each year of any season. Each year of his career in the NBA, Petitioner had to "make" the team in order for PMSA or Interlit to be entitled to any payments for his services. The Tax Court assumed for purposes of its decision that PMSA and Interlit were bona-fide, unrelated corporations.

## REASONS FOR ALLOWANCE OF THE WRIT

The statement of Questions Presented for Review, *ante*, sets forth important questions regarding the interpretation and application of federal income tax law under the anticipatory assignment of income doctrine first declared in *Lucas v. Earl*, 281 U.S. 111 (1930), and continually defined and refined to adjust the application of the doctrine to the reality of our nation's commercial activity.

These questions deal with the circumstances under which an individual taxpayer situated as described above may be subjected to federal income tax liability on income never received by the taxpayer and received instead by a bona-

fide, arm's length, unrelated third party. Arguments supporting the importance of these questions and the need for their determination by this Court follows separately after each question.

*Question 1.* Whether, in the circumstances described above, the taxpayer must have a vested, unrestricted claim to future income at the time he enters into the exclusive personal services contract with the licensing corporation in order for the individual taxpayer to be liable for federal income taxes on the compensation paid by the NBA teams to the corporation.

On this issue, Petitioner's position is positive because on its face and as a matter of law a taxpayer cannot be liable for federal income taxes based upon possible income the taxpayer might or might not receive and to which he has neither a vested right nor an unrestricted claim.

On this issue the Ninth Circuit is apparently divided from the other Circuits. The Ninth Circuit, in this case, while accepting the trial court's recognition and acknowledgment that the Petitioner had no vested, unrestricted right to any NBA income when he entered into the exclusive personal services contract with PMSA on August 16, 1974, has held Petitioner liable for federal income taxes on amounts subsequently paid by the NBA teams to PMSA's assignee, Interlit. Other Circuits have held, citing this Court's decision in *Harrison v. Schaffner,* 312 U.S. 579 (1941), that the rule applicable to anticipatory assignment of income applies when the assignor (Petitioner herein) is entitled at the time of the assignment (August 16, 1974 herein) to receive the income at a future date and is vested with an unrestricted claim to the income. *Wood Harmon Corporation v. United States,* 311 F.2d 918 (2nd Cir. 1963); *Cold Metal Process Co. v. Commissioner,* 247 F.2d 864 (6th Cir. 1957); *Commissioner v. Oates,* 207 F.2d 711 (7th Cir. 1953).

The Court below apparently deviated from this approach and divided itself from the other Circuits.

There are numerous cases which address the proper tax treatment for individuals operating under a personal services contract with a corporation. In some of these cases the personal services contracts were recognized for income tax purposes,[4] and in others the individual's tax liability was modified because an assignment of vested, guaranteed income was found.[5]

The licensing corporation involved herein, PMSA, has on other occasions entered into personal services contracts with individuals. One of these contracts was examined in *Estate of Cole v. Commissioner,* 32 TCM 1973-74, Dec. 31,909(M). The taxpayer in *Cole* was Nat "King" Cole, an internationally known entertainer. *Cole* is particularly relevant to this case because the same corporation, PMSA, is involved, and the issue decided included assessments by the IRS based on the theory that Cole had assigned income taxable to him under I.R.C. § 61. The Court, on page 314 of its opinion, stated the anticipatory assignment of income issue as follows:

> Whether amounts paid by Capitol Records, Inc., to Associated Arts, N.V. (AA), a Netherlands Antilles Corporation in excess of the amounts paid by AA to Nathaniel Cole (Cole) in the years 1961 through 1964,

---

[4]*Fox v. Commissioner,* 37 B.T.A. 271 (1938); *Laughton v. Commissioner,* 40 B.T.A. 101 (1939); *Gettler v. Commissioner,* 34 TCM 1975-87, Dec. 33,124(M); *Estate of Cole v. Commissioner,* 32 TCM 1973-74, Dec. 31,909 (M).

[5]*Lucas v. Earl,* 281 U.S. 111 (1930); *Moline Properties v. Commissioner,* 319 U.S. 436 (1943); *Foglesong v. Commissioner,* 35 TCM 1976-294, Dec. 34,024(M); *Rubin v. Commissioner,* 460 F.2d 1216 (1972).

constitute income of Cole which he attempted to assign to AA. . .[6]

The Court held that there was no assignment of income taxable to petitioner under I.R.C. § 61.

The *Cole* Court addressed the assignment of income issue and, on page 322, quoting from *Wood Harmon Corp. v. United States, supra,* stated:

> The philosophy underlying these cases is that the taxpayer has performed services or has a vested interest in property which gives him an unrestricted claim to compensation or income therefrom; the exercise of the unfettered power to dispose of that income is deemed analogous to its enjoyment or realization, resulting in a tax upon the assignor rather than upon the assignee who receives the income in fact.[5]
>
> [5]It has been stated that the "rule" applicable to an anticipatory assignment of income applies when the assignor is *entitled* at the time of the assignment to receive the income at a future date and is *vested* with such a right." *Cold Metal Process Co. v. Commissioner,* 247 F.2d 864, 873 (6th Cir. 1957). (emphasis in original)
>
> As the Court in *Wood Harmon Corp., supra,* so clearly pointed out in its footnote to the statement we quoted, the rule applicable to an assignment of income applies when the assignor is entitled at the time of assignment to the income at a future date and is vested with such a right. In clear distinction to this type of case are those cases such as *James F. Oates,* 18 T.C. 570 (1952), *aff'd,* 207 F.2d 711 (C.A. 7, 1953), and *Ernest K. Gann,* 31 T.C. 211 (1958), where the income which

---

[6]Stated in terms of this case, the issue would read: "Whether amounts paid by the Warriors (or Bullets) to Interlit, in excess of the amounts paid by Interlit to Petitioner Johnson in the years 1975 through 1977, constitute income of Johnson which he attempted to assign to Interlit . . ."

> respondent was contending had been assigned were amounts which would become due only upon the happening of future events and the taxpayer had assigned his contractual right to such payments if and when they became due under the contract in return for some immediate or deferred payment. As we pointed out in *Ernest K. Gann, supra,* in order for a taxpayer to have constructively received income, such income must be actually available to him and he merely refuses to accept it himself, or if the case involves assignment, assigns the right to receive it to another. Where, as in the instant case, the amount is not due or subject to the taxpayer's demand but will only arise upon the occurrence of a future event, the income is not constructively received by a taxpayer and an assignment of the contractual rights is not an assignment of income but of a contractual right.

*Cole* recognized the doctrine of anticipatory assignment of income as it has developed since *Lucas v. Earl, supra.*

On August 16, 1974, Petitioner entered into a personal services contract with PMSA. On August 16, 1974, Petitioner did not have a contract to play for the Warriors (or anyone else) for the 1974-75 NBA season (or any other season). Petitioner had performed no services, possessed no right to receive income, and had no interest in any contract with the Warriors that gave him an unrestricted claim to compensation or income from the Warriors. Petitioner had nothing to assign. Petitioner did have a guaranteed income from PMSA. The guaranteed payments were made pursuant to that contract on a monthly basis.

Petitioner received and reported as his income the payments from PMSA.[7] These payments were consistently

---

[7]"Where there is an arm's length assignment of income rights for a valuable consideration received, it is clear that the assignor realizes only the amount of the consideration received, Rhodes v.

made each month whether or not the Warriors or the Bullets paid Interlift.

Petitioner was placed on waivers in January, 1978, and received no compensation from the Warriors. PMSA still paid the monthly amounts. Petitioner was placed on waivers by the Bullets in September, 1979. He did not obtain employment as a professional basketball player for another 16 months. PMSA, or its successor in interest, continued its monthly payments to Petitioner during that time.

In *Teschner v. Commissioner,* 38 T.C. 1003 (1962), the Court recognized the fallacy of an over-simplistic application of the rule in *Lucas v. Earl, supra.*

> In his ruling, the respondent declared, "The basic rule in determining to whom an item of income is taxable is that income is taxable to the one who earns it." If by this statement the respondent means that income is in all events includible in the gross income of whomsoever generates or creates the income by virtue of his own effort, the respondent is wrong. If this were the law, agents, conduits, fiduciaries, and others in a similar capacity would be personally taxable on the proceeds of their efforts. . . . The employee would be taxable on income generated for his employer by his efforts. Such results, completely at variance with every accepted concept of Federal income taxation, demonstrate the fallacy of the premise.

*Teschner v. Commissioner, supra,* at 1007.

In a concurring opinion, Judge Dawson stated:

> *Harrison v. Shaffner,* 312 U.S. 579 (1941), settled the proposition that there can be no anticipatory assign-

---

Commissioner, 1941, 43 B.T.A. 780, affirmed 6 Cir. 1942, 131 F.2d 50, and the assignee is taxable for receipts in excess of this amount. See Blair v. Commissioner, 1937, 300 U.S. 5, 57 S.Ct. 330, 81 L.Ed.; G.C.M. 24849, 1946-1 Com. Bull 66, 67-68" *Cotlon v. Commissioner,* 228 F.Rptr.2d 186, 188.

> ment of income unless the assignor is entitled at the time of assignment to receive the income at a future date and is vested with such a right. . . . Consequently, the cases cited by the dissent, *Lucas v. Earl,* 281 U.S. 111 (1930), *Helvering v. Horst,* 311 U.S. 112 (1940), and *Helvering v. Eubank,* 311 U.S. 122 (1940), all of which held that "one *vested with the right to receive income* [does] not escape the tax by any kind of anticipatory arrangement, however skillfully devised," *Harrison v. Shaffner, supra, at* 582 (emphasis supplied) are inapposite here.

*Teschner v. Commissioner, supra,* at 1009-1110.

The proper application of the rule set down in *Lucas v. Earl, supra,* requires the taxpayer to have a vested and unrestricted claim to compensation. The Sixth Circuit, in *Cold Metal Process Co. v. C.I.R.,* 247 F.2d 864, 872, 873 (6th Cir. 1957), stated:

> In *Harrison v. Schaffner, supra,* 312 U.S. 579, at pages 580 and 582, 61 S.Ct. 759, the Supreme Court stated that the rule applicable to an anticipatory assignment of income applies when the assigner is *entitled* at the time of the assignment to receive the income at a future date and is *vested* with such a right.

*Question No. 2.* Whether, in the circumstances described above, the individual taxpayer, subsequent to his entering into the contract with the licensing corporation, can execute a contract with the NBA teams without becoming liable for federal income taxes on the payments thereafter made by the NBA team to the licensing corporation for the taxpayer's services.

On this issue Petitioner's position is positive because there is no requirement that a contract be executed by the licensing corporation so long as the taxpayer observes his

contractual obligations to the licensing corporation while performing for the NBA teams.

The Seventh Circuit has recognized this position, stating in *Foglesong v. Commissioner,* 621 F.2d 865 (7th Cir. 1980):

> The Tax Court here also places much emphasis on the absence of a written employment contract and/or covenant not to compete between taxpayer and the corporation. *The elevation of form over substance in this analysis is manifest.* (emphasis supplied)

*Foglesong, supra,* at 872.

*Foglesong* was addressing the Tax Court requirement of a written employment contract between the sole shareholder and a licensing corporation which he owned. The same analysis would apply to a contract between the licensing corporation and the NBA teams as recognized in *R. & L., Inc. v. Commissioner,* 84 F.2d 721 (1936), discussed below.

The Ninth Circuit is apparently divided from the Seventh Circuit by holding in this case that the "crucial" fact is Petitioner's execution of the contract with the NBA teams rather than Interlit's or PMSA's execution of the contract with the NBA teams.

The applicable law has been a constant since the decision in *R. & L. Inc. v. Commissioner, supra.* In that case, Mr. E. V. Richards had a contract with Metro-Goldwyn. The corporate minutes of R. & L. contained a resolution that E. V. Richards was to turn over the earnings and commissions of Metro-Goldwyn to R. & L., Inc. Commissions were paid by Metro-Goldwyn directly to E. V. Richards. E. V. Richards endorsed these commission checks over to his corporation, R. & L., Inc. There was no assignment of the contract between Metro-Goldwyn Corp. and E. V. Richards, and no novation was shown. It is doubtful

that Metro-Goldwyn even knew that R. & L., Inc. existed. The court held that the commissions received by E. V. Richards were compensation for R. & L., Inc.'s services performed by the corporation through its employee, and found that the individual taxpayer signing the contract was not liable for federal income taxes on payments made thereafter by Metro-Goldwyn for his services.

In this case, the August 16, 1974 contract between Petitioner and PMSA is a personal services contract. In exchange for guaranteed compensation, Petitioner agreed that PMSA would have the exclusive right to license his professional athletic services to others. PMSA assigned this license right to Interlit. Interlit licensed Petitioner's services to the Warriors and the Bullets. The Warriors and the Bullets paid all money due for Petitioner's services to Interlit. The IRS contends that Petitioner should be taxed on the money paid by the Warriors and Bullets to Interlit rather than be taxed upon the compensation paid to Petitioner under the August 16, 1974 PMSA contract.

The Court below imposed an income tax liability on Petitioner for money paid by the Warriors and the Bullets to someone other than Petitioner (e.g., Interlit), on the sole grounds that no contract was executed between PMSA or Interlit and the Warriors or Bullets. The requirement of such a contract, and the Court below's subsequent imposition of tax liabilities on Petitioner, deviates from the law established as early as 1936 in *R. & L., Inc. v. Commissioner*. (See also *Shellabarger v. Commissioner*, 38 F.2d 566 (1930).)

So long as Petitioner recognizes and observes his contractual obligations and responsibilities with PMSA and Interlit (the substance), there is not, and has not been since 1936, any requirement that PMSA or Interlit execute a contract with the NBA teams (the form).

## CONCLUSION

For all of the reasons stated above, this Petition for writ of certiorari should be granted.

Respectfully submitted,

ROBERT L. DUNNETT
DUNNETT, BAYS & O'CONNELL
Attorneys at Law
50 University Ave.
P.O. Box 1847
Los Gatos, CA 95031
(408) 354-3520

**(Appendices follows)**

## Appendix A

United States Court of Appeals
For the Ninth Circuit

No. 82-7505

Tax Nos. 10335-79
11668-80

Charles Johnson,
Petitioner-Appellant,

vs.

Commissioner of Internal
Revenue,
Respondent-Appellee.

[Filed April 16, 1984]

MEMORANDUM

Appeal from the United States Tax Court
Argued and Submitted March 13, 1984

Before: HUG and FERGUSON, Circuit Judges,
and BYRNE,* District Judge.

Appellant, Charles Johnson, appeals a ruling by the Tax Court that during the taxable years 1975, 1976, and 1977 he was the true earner of certain compensation paid by the San Francisco Warriors basketball team ("Warriors") and was, therefore, taxable thereon. Johnson asserts that since he had conveyed the exclusive rights to his services to a third party before he entered into a contract with the Warriors, the compensation paid by the Warriors under that contract was income to the third party rather than to himself.

---

*The Honorable William M. Byrne, Jr., United States District Judge for the Central District of California, sitting by designation.

This case is essentially similar to a previous case decided by this court involving the same appellant, *Johnson v. United States*, 698 F.2d 372 (9th Cir. 1982), *reh. and reh. en banc denied* (1983). That case involved the taxable year 1978 and a contract with the Washington Bullets basketball team in addition to one with the Warriors. We held that the compensation paid under those contracts was income attributable to Johnson because "neither the Warriors nor the Bullets had contracted with [the third party]. They had contracted directly with [Johnson] for his services as their employee on salary." *Id.* at 374. The same crucial fact is operative in the present case, and the outcome must be the same.

The decision of the Tax Court is therefore AFFIRMED.**

---

**The panel has concluded that the issues presented by this appeal do not meet the standards set by Rule 21 of the Rules of this Court for disposition by written opinion. Accordingly, it is ordered that disposition be by memorandum, foregoing publication in the *Federal Reporter*, and that this memorandum may not be cited to or by the courts of this circuit.

## Appendix B

78 T. C. No. 62

United States Tax Court

Charles Johnson, Petitioner v. Commssioner of Internal Revenue, Respondent

Docket Nos. 10335-79, 11668-80.

Filed June 7, 1982.

Petitioner, a professional basketball player, executed a contract with an unrelated corporation whereby he granted the corporation the right to his services in professional sports for a limited time, and the corporation agreed to pay petitioner a monthly sum. Petitioner played for a professional basketball club with which he signed player contracts. The club remitted the compensation for petitioner's services to the corporation pursuant to assignments of contract rights executed by petitioner. However, there existed no contract between the club and the corporation. *Held,* petitioner, rather than the corporation, actually controlled the earning of the amounts paid by the basketball club, and those amounts are income to him. *Laughton v. Commissioner,* 40 B.T.A. 101 (1939), and *Fox v. Commissioner,* 37 B.T.A. 271 (1938), distinguished.

*Harry Margolis* and *Robert L. Dunnett,* for the petitioner.

*William E. Bonano* and *Henry E. O'Neill,* for the respondent.

FAY, *Judge:* Respondent determined deficiencies of $34,698, $35,747, and $40,832 in petitioner's Federal income tax for 1975, 1976, and 1977, respectively. At issue is whether amounts paid by a professional basketball club

with respect to petitioner's services are income to petitioner or to a corporation to which the payments were made.

These cases are consolidated for trial, briefing, and opinion.

## FINDINGS OF FACT

Some facts are stipulated and found accordingly.

Petitioner, Charles Johnson, was a resident of Oakland, Calif., when he filed his petitions herein.

During the years in issue, Charles Johnson (hereinafter petitioner) was a professional basketball player. He began playing in the National Basketball Association (NBA) in the fall of 1972. On September 14, 1972, he signed an NBA Uniform Player Contract with the San Francisco Warriors (Warriors). That contract obligated him to play basketball for the Warriors for one year in return for $17,500. On October 5, 1973, petitioner signed a second NBA Uniform Player Contract with the Warriors. That contract, covering the 1973-1974 NBA season, ran for one year from September 1, 1973, and provided for $40,000 compensation.

Although petitioner's 1973-1974 contract with the Warriors did not expire until the fall of 1974, the actual playing season ended much earlier, and all compensation due petitioner was to be paid by the conclusion of the playing season. An NBA player may be through playing basketball as early as March or as late as late May depending on whether he is involved in the NBA playoffs. However, a player under contract has certain post-playing season duties such as keeping in good physical condition and doing requested promotional work. Nevertheless, once the playing season is over, a player may "pretty much do anything [he wants] to do." Certain provisions of petitioner's 1973-1974 contract with the Warriors carried significance after the playing season. For example, the Warriors could have traded petitioner, and the Warriors had the right to renew the contract for one year.

During the summer of 1974 and after the conclusion of the actual 1973-1974 playing season, petitioner followed the advice of a friend and contacted Robert L. Dunnett (Dunnett), a California attorney, concerning financial planning. That contact led to petitioner's signing an agreement on August 16, 1974, with Presentaciones Musicales, S.A. (PMSA), a Panamanian corporation. In very general terms, that agreement (hereinafter the PMSA-petitioner agreement) gave PMSA the right to petitioner's services in professional sports for six years beginning August 16, 1974; gave PMSA the right to control petitioner's services with respect to professional sports; and obligated PMSA to pay petitioner $1,500 per month.[1] On August 20, 1974, PMSA licensed its rights and obligations under the PMSA-petitioner agreement to EST International Limited (EST), a British Virgin Islands limited liability company. Under that licensing arrangement, EST was obligated to pay any expenses and to make the payments to petitioner required under the PMSA-petitioner agreement. EST was to remit to PMSA 95 percent of the "net revenue" collected by EST under the PMSA-petitioner agreement.[2]

Dunnett, representing petitioner, entered into negotiations with the Warriors for a new contract for petitioner's services. The Warriors were adamant about having an NBA Uniform Player Contract signed by the player, and thus rejected a proposed licensing contract between the Warriors and PMSA.

Given the Warrior's insistence on an NBA Uniform Player Contract, petitioner signed such a contract with the Warriors on August 27, 1974. That contract ran for

---

[1]The PMSA-petitioner agreement and later amendments thereto are discussed in more detail, *infra*.

[2]Sometime before May 12, 1976, EST changed its name to Interlit (British Virgin Islands) Limited. We shall continue to refer to EST even though certain payments were made to Interlit, and Interlit was a party to certain agreements.

two years from September 1, 1974, and covered the 1974-1975 and 1975-1976 seasons. While the stated compensation for those seasons was $45,000 and $55,000, respectively, the contract was a "make" contract. Thus, under that contract, petitioner became entitled to the full compensation for a season only if he was a team member after the December 2nd falling within that season.

Even though the August 27, 1974, NBA Uniform Player Contract provided for compensation payments to begin on November 1, 1974, no regular payments were made under the contract until June 1975.[3] The delay in payments resulted from Dunnett's continuing efforts to have the Warriors in some way recognize the August 16, 1974, PMSA-petitioner agreement.[4] The Warriors refused to sign any contract or agreement with any person or entity other than petitioner. However, they did agree to remit the contract payments to someone other than petitioner, if petitioner legally assigned the payments.

On April 25, 1975, petitioner executed an Assignment of Contract Rights assigning all contract payments to EST. After that assignment, all contract payments were made to EST.[5] Check stubs reflected the payments as being for petitioner's services. Federal and state income tax, NBA Players Association dues, and fines were withheld from the payments.

---

[3]Certain per diem checks for on-the-road expenses were issued to petitioner during the playing season.

[4]By letter dated October 28, 1974, petitioner instructed the Warriors not to make a salary payment to him.

[5]Further Assignments of Contract Rights were executed by petitioner in favor of EST on September 20, 1975, covering the NBA Uniform Player Contract dated September 1975 and on September 9, 1977, covering the August 1977 NBA Uniform Player Contract. Furthermore, on June 8, 1977, petitioner authorized release of a playoff bonus check to EST.

After payments to EST were arranged, nothing further developed between petitioner, the Warriors, and either PMSA or EST. On September 15, 1975, petitioner signed an NBA Uniform Player Contract with the Warriors covering the 1975-1976 and 1976-1977 seasons. Compensation was set at $85,000 and $90,000, respectively.[6] On August 29, 1977, petitioner signed an NBA Uniform Player Contract with the Warriors for the 1977-1978, 1978-1979, and 1979-1980 seasons. Compensation was set at $100,000, $110,000, and $125,000, respectively. Both of these contracts, covering five seasons, were "make" contracts. See p. 5, *supra*.

Sometime after December 16, 1977, petitioner was waived by the Warriors and cleared waivers. On January 24, 1978, he signed an NBA Uniform Player Contract with the Capital Bullets Basketball Club, Inc. T.A. Washington Bullets (Bullets) for ten days.[7] On January 30, 1978, he signed an NBA Uniform Player Contract with the Bullets covering the remainder of the 1977-1978 season and the 1978-1979 and 1979-1980 seasons. It was a "make" contract with compensation set at $13,104 for the remainder of the 1977-1978 season and at $100,000 for each of the two following seasons. On November 16, 1978, the Bullets and petitioner entered into an agreement whereby the January 30, 1978, NBA Uniform Player Contract was adopted, the PMSA-petitioner agreement was acknowledged, and the Bullets agreed to remit all contract payments to EST.

---

[6]The September 15, 1975 contract superseded the August 27, 1974 contract with respect to the 1975-1976 season.

[7]When petitioner cleared waivers and then signed with the Bullets, the Warriors claimed they could deduct from the payments due from them under their contract with petitioner the amounts paid by the Bullets for the same period. The dispute went to arbitration resulting in a decision against the Warriors. The resulting payment went to EST.

All payments with respect to the 1977-1978 season went to EST. Petitioner left the Bullets in October 1979.

In summary, all payments due under various NBA Uniform Players Contracts executed on and after August 27, 1974, went to EST. See n. 3, *supra*. No payments have been made to EST since petitioner left the Bullets.

The PMSA-petitioner agreement gave PMSA the right to require petitioner to perform services but acknowledged that any regulations of any professional association would control. That agreement provided both that "[b]asic commercial and economic control of [petitioner's] services is intended to reside in PMSA at all times," and that petitioner "shall not undertake to perform personal athletic services of any kind for the duration of this agreement without the prior written approval of PMSA." Neither PMSA nor EST in any way actively participated in negotiations with the Warriors or in petitioner's playing of basketball. At trial, petitioner acknowledged no change with respect to his working relationship with the Warriors occurred after the PMSA-petitioner agreement was executed.

As previously noted, the PMSA-petitioner agreement gave PMSA the right to petitioner's services in professional sports for six years and obligated PMSA to pay petitioner $1,500 per month. The $1,500 per month was listed as "compensation for initial term [six years]" and was made payable to petitioner for his life.[8] However, the agreement provided further:

> Should JOHNSON [petitioner] fail to perform services under any license arrangement [unless he is incapacitated] to any professional athletic team or related athletic endeavor for any consecutive twenty-four (24) month period, * * *, PMSA may bring this

[8]PMSA was given an option to renew the PMSA-petitioner agreement for six more years.

> Agreement to an end and shall retain without the necessity of making any further payment of any kind to JOHNSON all the rights held by PMSA under this agreement.

Thus, if petitioner, for twenty-four consecutive months, failed to perform under any athletic license to a professional team, PMSA was relieved of its obligation to pay petitioner.

The PMSA-petitioner agreement was amended by a letter dated September 16, 1976. Two basic changes were made—the payment to petitioner was increased to $2,000 per month[9] and a previously initiated loan program, discussed in more detail, *infra*, was approved. A second amendment was executed on December 16, 1977. While that amendment concentrated on the loan arrangement, it also operated as an exercise of PMSA's option to extend the original agreement for six years since petitioner's "current agreement with PMSA * * * terminates on August 15, 1980."

In December 1974, PMSA loaned petitioner $10,000 interest free so petitioner could invest in a partnership. Petitioner later sold his partnership interest and repaid the $10,000 in December 1975. After the end of the 1974-1975 playing season, petitioner wanted to buy a house, and PMSA agreed to loan petitioner $74,000 interest free with payment due on October 1, 1980. The $74,000 was disbursed to petitioner in $750 monthly increments beginning in September 1975, and one $32,000 advance in November 1975. Those loans were made part of the original PMSA-peti-

---

[9]The original PMSA-petitioner agreement required cost-of-living increases in the monthly payments to petitioner. However, no such increases were made between August 1974 and September 1976. By the September 1976 agreement, petitioner agreed to an increase to $2,000 per month in lieu of the cost-of-living increases and agreed to no further increases until August 1978. At the time of trial, the $2,000 per month amount was still in effect.

tioner agreement by the September 16, 1976, amendment.[10] The December 16, 1977, amendment increased the loan commitment from PMSA to petitioner to $250,000 and required petitioner to give security for past and present loans.

On September 29, 1980, an agreement (hereinafter the Associated Advisors agreement) was executed by and between PMSA, EST, petitioner, and Associated Advisors, a California corporation. Associated Advisors was formed several years before by Dunnett and lawyers with whom he practiced. The Associated Advisors agreement recalled the PMSA-petitioner agreement and the 1976 and 1977 amendments thereto and provided:

> Under the terms and conditions of [those] agreements, PMSA (or its assignee) is presently obligated to pay certain compensation to Johnson [petitioner] of at least Two Thousand Dollars ($2,000.00) per month to and through December, 1983.

Pursuant to the Associated Advisors agreement, Associated Advisors assumed that liability of PMSA and EST, and acquired all of PMSA and EST's liabilities and rights under the previous agreements and amendments.

The Associated Advisor's agreement noted that petitioner owed PMSA $226,500 which was due by October 1, 1980. Associated Advisors agreed to loan petitioner $226,500, at 10 percent interest, to repay PMSA, and peti-

---

[10]On July 1, 1975, petitioner purchased a house in Oakland, Calif., for $98,000 with financing by Great Western Savings and Loan Association in Oakland. As of June 15, 1976, only $62,000 remained to be paid. By early 1979, the entire balance due had been paid. On April 12, 1979, petitioner executed a deed of trust on his house in favor of PMSA, to secure the loans pursuant to the December 16, 1977, amendment. The trustor was Seabright Land Corporation, and its president was Kenneth Reisserer who practiced in the same office at Dunnett.

tioner agreed to execute a Deed of Trust in favor of Associated Advisors. The loan from Associated Advisors was on the following terms: (1) if petitioner's services were licensed for "at least one (1) year before October 1, 1981," the loan accrues interest until twelve consecutive unlicensed months pass and is then fully amortized over five years and payable in monthly increments or (2) if petitioner's services are not licensed "for a period of at least one (1) year before October 1, 1981," the entire loan is payable on October 1, 1981. Both at the time the Associated Advisors agreement was executed and at the time of trial in August 1981, petitioner's services were not licensed.

As to the monthly payments due petitioner under the PMSA-petitioner agreement and amendments thereto, the Associated Advisors agreement provided:

> Advisors and Johnson [petitioner] agree that the compensation payments to Johnson * * * shall cease as of October 1, 1981, if Johnson's services have not been licensed for a period of at least one (1) year. If, on or before October 1, 1981, Johnson's services are licensed for one (1) year or more, Advisors shall pay to Johnson all compensation due to Johnson under the agreements.

Thus, the length of time petitioner received his monthly payments depended on whether his services were licensed by October 1, 1981.

On his Federal income tax returns for 1975, 1976, and 1977, petitioner reported no wages or salary, but did report the payments he received from EST as business income. He attached to those returns Forms W-2 issued by the Warriors with respect to his services. Petitioner received refunds of Federal income tax with respect to 1975, 1976 and 1977. Those refund checks, as well as checks representing refunds of state income taxes, were specially endorsed by petitioner to EST. See n. 2, *supra*. By a statement

attached to an application for an extension to file for 1975, petitioner disclosed his reporting position with respect to personal service income.

In his statutory notices of deficiency, respondent determined all amounts paid by the Warriors in 1975, 1976, and 1977 with respect to petitioner's services were income to petitioner. Thus, he increased petitioner's income by $60,894, $67,060, and $70,327 for 1975, 1976, and 1977, respectively. Those increases reflect the excess of the amounts paid by the Warriors with respect to petitioner's services over the amount paid petitioner by EST with respect to those services.

## OPINION

At issue is whether amounts paid by the Warriors with respect to petitioner's services as a basketball player are income to petitioner or to the corporation to which the amounts were remitted. Respondent, relying on the rule of *Lucas v. Earl,* 281 U.S. 111 (1930), that income must be taxed to its earner, contends petitioner was the true earner. Petitioner maintains this is a "loan-out" case like *Fox v. Commissioner,* 37 B.T.A. 271 (1938), and *Lucas v. Earl* is inapplicable.[11] We find *Lucas v. Earl* indis-

---

[11]Petitioner makes no contention, given the payments required to be made to him by EST, that his contractual rights with the Warriors were sold. The parties debate this case solely on the "who" aspect of the assignment of income doctrine, and make no arguments concerning the "when" aspect of that doctrine. See generally *Estate of Stranahan v. Commissioner,* 472 F.2d 867 (6th Cir. 1973), revg. and remanding a Memorandum Opinion of this Court; *Martin v. Commissioner,* 56 T.C. 1255 (1971), affd. without published opinion (5th Cir., Aug. 18, 1972). Thus, we do not decide whether petitioner received adequate consideration in his dealings with PMSA and EST. However, we note there is confusion as to the duration of the monthly payments from EST to petitioner, and petitioner has offered no clarifying evidence. See Rule 142(a), Tax Court Rules of Practice and Procedure.

tinguishable in any meaningful sense and hold for respondent.[12]

In *Lucas v. Earl,* the taxpayer executed an agreement with his wife that any property acquired by either of them, including wages salary, would be considered joint property. The United States Supreme Court accepted the validity of that contract, but held the taxpayer earned the salary in issue therein and must be taxed on it. In so holding, the Court noted:

> It [the case] turns on the import and reasonable construction of the taxing act. There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute [section 61] before us * * *. 281 U.S. at 114-115.

From that quote is derived the oft-cited "first principle of income taxation: [t]hat income must be taxed to him who earns it." *Commissioner v. Culbertson,* 337 U.S. 733, 739-740 (1949). See also *United States v. Basye,* 410 U.S. 441, 449 (1973).

However, the realities of the business world prevent an over-simplistic application of the *Lucas v. Earl* rule whereby the true earner may be identified by merely pointing to the one actually turning the spade or dribbling the

---

[12]Given our holding, we need not address respondent's alternate contention that the arrangement between petitioner and the various entities, other than the Warriors, was a sham. Nor do we address petitioner's argument, based on *Cole v. Commissioner,* T.C. Memo. 1973-74, that collateral estoppel requires us to recognize PMSA as an independent viable corporation. However, for the purpose of reaching our specific holding herein, we accept petitioner's characterization of PMSA.

ball. Recognition must be given to corporations as taxable entities which, to a great extent, rely upon the personal services of their employees to produce corporate income. When a corporate employee performs labors which give rise to income, it solves little merely to identify the actual laborer. Thus, a tension has evolved between the basic tenets of *Lucas v. Earl* and recognition of the nature of the corporate business form.[13]

While the generally accepted test for resolving the "who is taxed" tension is who actually earns the income, that test may easily become sheer sophistry when the "who" choices are a corporation or its employee. Whether a one-person professional service corporation or a multi-faceted corporation is presented, there are many cases in which, in a practical sense, the key employee is responsible for the influx of moneys. Nor may a workable test be couched in terms of for whose services the payor of the income intends to pay. In numerous instances, a corporation is hired solely in order to obtain the services of a specific corporate employee.[14]

---

[13]That tension is most acute when a corporation operates a personal service business and has as its sole or principal employee its sole or principal shareholder. In those cases where sec. 482 applies, resort to general sec. 61 principles usually is not necessary since sec. 482 provides a smoother route to the same "who is taxed" result. See *Pacella v. Commissioner*, 78 T.C. (Apr. 14, 1982); *Keller v. Commissioner*, 77 T.C. 1014 (1981), appeal filed (10th Cir. Apr. 2, 1982). However, see *Rubin v. Commissioner*, 51 T.C. 251 (1968), revd. and remanded 429 F.2d 650 (2d Cir. 1970), decided on remand 56 T.C. 1155 (1971), affd. per curiam 460 F.2d 1216 (2d Cir. 1972), wherein application of sec. 61 and 482 led to different results. Unless otherwise provided, all section references are to the Internal Revenue Code of 1954, as amended.

[14]Such instances are commonplace in personal service businesses such as law, medicine, accounting, and entertainment. See e.g., *Cole v. Commissioner, supra*, n. 12.

Given the inherent impossibility of logical application of a *per se* actual earner test, a more refined inquiry has arisen in the form of who controls the earning of the income. See *Vercio v. Commissioner,* 73 T.C. 1246, 1254-1255 (1980). An examination of the case law from *Lucas v. Earl* hence reveals two necessary elements before the corporation rather than its service-performer employee may be considered the controller of the income.[15] First, the service-performer employee must be just that—an employee of the corporation who the corporation has the right to direct or control in some meaningful sense. See *Vnuk v. Commissioner,* 621 F.2d 1318, 1320-1321 (8th Cir. 1980), affg. a Memorandum Opinion of this Court; *Vercio v. Commissioner, supra.* Second, there must exist between the corporation and the person or entity using the services a contract or similar indicium recognizing the corporation's controlling position. See *Pacella v. Commissioner,* 78 T.C. ..... (Apr. 14, 1982); *Keller v. Commissioner,* 77 T.C. 1014, appeal filed (10th Cir., Apr. 2, 1982).[16]

In the case before us, we accept arguendo that the PMSA-petitioner agreement was a valid contract which required the payments with respect to petitioner's performance as a basketball player ultimately to be made to PMSA or EST. See n. 12, *supra.* We also accept arguendo that the PMSA-petitioner agreement gave PMSA a right of control over petitioner's services, although respondent maintains the agreement's control provisions systematically were ignored.

---

[15]Although some of the cited cases deal with trusts rather than with corporations, their discussion of general sec. 61 principles applies to both entities. See sec. 1.671-1(c), Income Tax Regs. We couch our discussion herein in terms of corporations simply because it comports with the facts before us.

[16]See also *Foglesong v. Commissioner,* T.C. Memo. 1976-294, revd. and remanded 621 F.2d 865 (7th Cir. 1980), decided on remand under sec. 482, 77 T.C. 1102 (1981), appeal filed (7th Cir., Feb. 16, 1982).

See pp. 7-8, *supra*. Thus, the first element is satisfied. However, the second element is lacking, and that is what brings this case within *Lucas v. Earl* rather than the cases relied on by petitioner.

In *Fox v. Commissioner*, 37 B.T.A. 271 (1938), the taxpayer was a cartoonist who formed a corporation. He transferred to the corporation cash and property and assigned to the corporation copyrights and his exclusive services for a number of years. The corporation executed a contract with a syndicate giving the syndicate the right to use the taxpayer's cartoons in return for a percentage of gross sales. The amount the corporation thus received greatly exceeded the amount the corporation paid the taxpayer for his services. The Court held the excess amounts were not the taxpayer's income. *Lucas v. Earl* was inapplicable because the employment relationships existed between the corporation and the syndicate and between the corporation and the taxpayer and not between the taxpayer and the syndicate.[17]

In *Laughton v. Commissioner*, 40 B.T.A. 101 (1939),[18] the taxpayer, an actor, formed a corporation. He contracted with the corporation to receive a weekly payment and certain expense payments in return for his exclusive services. The corporation executed contracts with two film studios whereby the taxpayer's services were loaned to the film

---

[17]Petitioner also relies on the Second Circuit Court of Appeals reversal in *Rubin v. Commissioner, supra*, n. 15. However, as we understand the Court of Appeals' opinion, it merely mandated preferential application of sec. 482. Nevertheless, in *Rubin* there existed a contract between the taxpayer's corporation and the entity benefiting from the taxpayer's services.

[18]*Laughton v. Commissioner*, 40 B.T.A. 101 (1939), was remanded by the Ninth Circuit Court of Appeals, 113 F.2d 103 (9th Cir. 1940), solely for consideration of the effect, if any, which *Higgins v. Smith*, 308 U.S. 473 (1940), had upon respondent's argument that the corporation was the taxpayer's agent or alter ego.

studios,[19] The Court held the taxpayer was not taxable on the amounts paid to the corporation by the studios because those amounts were paid "under contracts between it [the corporation] and the studios" and there simply was no assignment of income by the taxpayer. See *Laughton v. Commissioner, supra* at 106-107.

Petitioner herein stands upon vastly different ground than did the taxpayers in *Fox* and *Laughton*. While petitioner had a contract with PMSA, and by assignment, EST, he also had an employment contract with the Warriors. Crucial is the fact that there was no contract or agreement between the Warriors and PMSA or EST. Nor can any oral contract between those entities be implied. See *Pacella v. Commissioner, supra*. The Warriors adamantly refused to sign any contract or agreement with any person or entity other than petitioner.[20] Thus, the existing employment relationships were between petitioner and PMSA/EST and between petitioner and the Warriors. The relationship between PMSA/EST and the Warriors necessary for PMSA/EST to be considered actually in control of the earnings was not present. As with Mr. Earl, petitioner "was the only party to the contracts by which the salary * * * [was] earned * * *." See *Lucas v. Earl*, 281 U.S. 111, 114 (1930).[21]

---

[19]Certain contracts executed by the taxpayer prior to formation of the corporation were assigned to the corporation.

[20]The reasons for the Warrior's refusal to so contract is not particularly relevant. However, many of the Warrior's concerns may perhaps be unique to professional sports. But, petitioner was not in a position where his goal of assured future income was unobtainable solely due to his choice of professions. Deferred compensation arrangements are common in professional sports, and many are accepted for tax purposes. See J. Weistart & C. Lowell, *The Law of Sports* § 7.06 (1979).

[21]We do not mean to impy this case necessarily would have been decided in petitioner's favor had a contract been executed between the Warriors and PMSA or EST. See n. 12, *supra*.

Nor may the assignments of earnings executed by petitioner suffice to make PMSA/EST the taxable party. Such assignments merely demonstrate petitioner's control over the earnings such as would an ordinary assignment of wages to a bank. Nor is it important that petitioner contractually was obligated to pay his earnings to PMSA/EST. The United States Supreme Court in *Lucas v. Earl* accepted the validity of the contract involved therein requiring transmission of one-half to Mrs. Earl, but nevertheless held Mr. Earl taxable as the true earner.

In summary, we find petitioner, rather than PMSA or EST, actually controlled the earning of the amounts paid by the Warriors with respect to petitioner's services. Thus, those amounts were income to petitioner under section 61(a)(1).[22]

To reflect the foregoing,

*Decisions will be entered for respondent.*

---

[22]Petitioner, relying on *Weimerskirch v. Commissioner*, 596 F.2d 358 (9th Cir. 1979), revg. 67 T.C. 672 (1977), maintains respondent's actions with respect to him were arbitrary and capricious, and the burden of proof should have shifted. *Weimerskirch* has no applicability herein. Our decision herein is not based on any presumption of correctness attaching to respondent's notice of deficiency or, to any great extent, upon the burden of proof. See generally *Karme v. Commissioner*, 73 T.C. 1163 (1980), affd. 673 F.2d 1072 (9th Cir. 1982). Indeed, we basically have accepted petitioner's version of the facts.

## Appendix C

United States Court of Appeals
For the Ninth Circuit

No. 81-4621

USDC No. CV 81-0086

Charles Johnson,
Plaintiff-Appellant,

v.

United States of America,
Defendant-Appellee.

[Filed Dec. 27, 1982]

### OPINION

On Appeal from the United States District Court
for the Northern District of California
Hon. Stanley A. Weigel, Presiding

Argued and Submitted: September 16, 1982

BEFORE: MERRILL, FLETCHER and BOOCHEVER, Circuit Judges.

MERRILL, Circuit Judge:

Appellant Johnson seeks refund of federal income taxes for the year 1978 in the sum of $52,606, and appeals from the district court's grant of summary judgment for the government.

I.

Appellant is a professional basketball player. In 1974 he signed a contract with a Panamanian Corporation, Presentaciones Musicales S.A. ("PMSA"), conveying to it the exclusive rights to his services as a professional athlete for a term of at least six years. In return, PMSA agreed to make monthly payments of $1,500.00 (later increased to

$2,000.00) to appellant for his life. PMSA later assigned the contract to EST International Limited, a British Virgin Islands corporation which later changed its name to Interlit.

Appellant played for two National Basketball Association teams during 1978: the Golden State Warriors and the Washington Bullets. He played for the Warriors under a contract negotiated and executed by him on August 29, 1977. Neither PMSA nor Interlit engaged in negotiations. Neither was a party to the contract. Appellant's attorney attempted to persuade the Warriors to contract with Interlit but on advice of its counsel, the Warriors refused, taking the position that it would contract with no one but appellant and would not be satisfied with a license from Interlit for his services.

Appellant then executed an assignment of his contract to Interlit and the Warriors paid appellant's salary directly to Interlit which then paid appellant the sums due under its contract with him.

In January 1978, the Warriors placed appellant on waivers and he later signed a two-year contract with the Bullets. Agan, he negotiated the contract himself and executed it himself. Neither PMSA nor Interlit was a party. In November 1978 appellant, the Bullets, PMSA and Interlit agreed that all sums due appellant under his contract with the Bullets should be paid directly to Interlit.

In his income tax return for 1978, appellant showed as income only the sums he had received from Interlit. The Commissioner gave appellant notice of deficiency declaring that all sums paid by the Warriors and the Bullets to Interlit, under appellant's assignments of income, were salary income of Appellant. Appellant paid the deficiency in the sum of $52,606.00 and, after the IRS denied his refund petition, filed this suit for refund. The district court granted

summary judgment for the United States and appellant took this appeal.

II.

The guiding principle in assignment of income cases is that income is taxed to the person or entity which in fact controls the earning of income. *Commisioner v. Culbertson,* 337 U.S. 733, 739-40 (1949); *see also United States v. Basye,* 410 U.S. 441, 449 (1973); *Lucas v. Earl,* 281 U.S. 111, 114-15 (1930). In *Vnuk v. Commissioner,* 621 F.2d 1318, 1320 (8th Cir. 1980), the court stated that the "choice of the proper taxpayer revolves around the question of which person or entity in fact controls the earning of the income rather than the question of who ultimately receives the income," *quoting Vercio v. Commissioner,* 73 T.C. 1246, 1253 (1980).

Johnson argues that he was under contract with PMSA and Interlit for his services and that his services were "loaned out" to the Warriors and Bullets. Where payment is for personal services of an individual who purports to be acting as an employee of a corporation and to have been "loaned out" to the contracting party, two crucial questions are presented: (1) whether the corporation has the right to control the activities of the individual and the amount of compensation the individual receives for those activities; and (2) whether this control has been recognized and accepted by the contracting party. *Vnuk v. Commissioner,* 621 F.2d 1318, 1320-21 & n. 5 (8th Cir. 1980) *Johnson v. Commissioner,* 78 T.C. 882, 891 (1982); *see Laughton v. Commissioner,* 40 B.T.A. 101, 106-07 (1939), *remanded on other grounds,* 113 F.2d 103 (9th Cir. 1940); *Fox v. Commissioner,* 37 B.T.A. 271, 278 (1938).

As the district court determined, the undisputed facts below indicated that the contracts between appellant and the two teams did not amount to a licensing agreement between PMSA or Interlit and the teams; that the teams had contracted with appellant alone; that appellant was an employee of the teams rather than of PMSA or

Interlit; and that appellant, not PMSA or Interlit, controlled the earning of the income sought to be taxed in 1978. The court concluded that appellant was liable for tax on the entire amount the teams had paid under the two player contracts.

Appellant disputes the court's conclusions. The crucial fact supporting the district court's holding, however, is that neither the Warriors nor the Bullets had contracted with Interlit. They had contracted directly with appellant for his services as their employee on salary. Indeed, the Warriors explicitly refused to contract with Interlit and rejected the acceptance of a license of appellant's services from Interlit. Similarly, even in November 1978, when the Bullets, Johnson, PMSA, and Interlit agreed that all payments by the Bullets for Johnson's services would be paid to Interlit, the parties explicitly acknowledged that the substance of the agreement was "a contract between PLAYER and CLUB." In both *Laughton v. Commissioner*, 40 B.T.A. 101, 106-07, and *Fox v. Commissioner*, 37 B.T.A. 271, 278, in which payments to a corporation in return for services of an individual were held to be income of the corporation and not the individual, the contracts in question were with the corporation and not with the individual. The distinction is crucial.

We conclude that the district court correctly held that appellant was taxable for the sums paid to Interlit for his services.

III.

Appellant contends that the Internal Revenue Service singled him out for audit because of his choice of lawyer. We find no merit in this contention and rejected precisely the same argument in *Karme v. Commissioner*, 673 F.2d 1062, 1064 (9th Cir. 1982) ("No impermissible selectivity is involved").

JUDGMENT AFFIRMED.

Office-Supreme Court, U.S.
FILED
SEP 4 1984
ALEXANDER L. STEVAS
CLERK

(2)

No. 84-159

# In the Supreme Court of the United States

OCTOBER TERM, 1984

---

CHARLES JOHNSON, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

---

## MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

---

REX E. LEE
*Solicitor General*
*Department of Justice*
*Washington, D.C. 20530*
*(202) 633-2217*

11pp

BEST AVAILABLE COPY

## TABLE OF AUTHORITIES

**Cases:** **Page**


*Cold Metal Process Co.* v. *Commissioner*, 247 F.2d 864 ..... 6
*Commissioner* v. *Oates*, 207 F.2d 711 ..... 7
*Commissioner* v. *Culbertson*, 337 U.S. 733 ..... 4
*Estate of Cole* v. *Commissioner*, 42 T.C.M. (P-H) ¶ 73,074 ..... 7
*Foglesong* v. *Commissioner*, 621 F.2d 865 ..... 8
*Harrison* v. *Schaffner*, 312 U.S. 579 ..... 4, 7
*Johnson* v. *United States*, 698 F.2d 372 ..... 3
*Lucas* v. *Earl*, 281 U.S. 111 ..... 4, 5, 6, 8
*R. & L., Inc.* v. *Commissioner*, 84 F.2d 721 ..... 8
*Teschner* v. *Commissioner*, 38 T.C. 1003 ..... 7
*United States* v. *Basye*, 410 U.S. 441 ..... 4, 7
*Vnuk* v. *Commissioner*, 621 F.2d 1318 ..... 5
*Wood Harmon Corp.* v. *United States*, 311 F.2d 918 ..... 7

# In the Supreme Court of the United States

OCTOBER TERM, 1984

---

No. 84-159

CHARLES JOHNSON, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

---

## MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

---

Petitioner seeks review of the decision of the court of appeals that he was the true earner of compensation paid during the taxable years 1975, 1976, and 1977, and was, therefore, taxable thereon.

1. Petitioner is a professional basketball player who, during the years in issue, played for the Golden State Warriors (Warriors) under National Basketball Association contracts (Pet. App. A4). On August 16, 1974, petitioner entered into an agreement with Presentaciones Musicales, S.A. (PMSA), by which he conveyed to PMSA the exclusive rights to his services as a professional athlete for six years in exchange for PMSA's promise to pay him $1,500

per month for life (*id.* at A5).[1] PMSA later licensed its rights and obligations under the agreement to EST International Limited (EST), which changed its name to Interlit (*ibid.*).

During the summer of 1974, Robert L. Dunnet, petitioner's attorney, negotiated extensively with the Warriors for a new contract for petitioner's services. The Warriors refused to enter into a "licensing" agreement with PMSA and insisted on contracting with petitioner directly. Accordingly, on August 27, 1974, petitioner and the Warriors signed a contract covering the 1974-1975 and 1975-1976 seasons. Pet. App. A5-A6.

No payments were made to petitioner until June 1975, because Dunnett continued to try, unsuccessfully, to create a contractual relationship between PMSA and the Warriors.[2] On April 25, 1975, petitioner executed an Assignment of Contract Rights assigning all payments under his contract with the Warriors to EST (PMSA's successor in interest). Thereafter, the Warriors made all payments, net of withheld federal and state income taxes, dues, and fines, to EST. Pet. App. A6.

On September 15, 1975, petitioner signed new contracts with the Warriors for the 1975-1976 and 1976-1977 seasons. On August 29, 1977, petitioner signed contracts with the Warriors for the 1977-1978 and 1978-1979 seasons. Neither PMSA nor EST participated in any of the negotiations with regard to these

---

[1] The agreement was amended in subsequent years to increase petitioner's monthly payment to $2,000 and to provide for loans to petitioner (Pet. App. A9).

[2] By letter dated October 28, 1974, petitioner had instructed the Warriors not to make any salary payments to him (Pet. App. A6 n.4).

contracts. Petitioner signed new Assignments of Contract Rights with respect to each of the above contracts. Pet. App. A7-A8.

Petitioner reported no wages or salary on his federal income tax returns for 1975, 1976, and 1977, but did report the payments he received from EST as business income. The Commissioner issued statutory notices of deficiency, determining that all amounts paid by the Warriors in 1975, 1976, and 1977 for petitioner's services were income to him. Pet. App. A11-A12.

Petitioner filed a petition for redetermination with the Tax Court. That court sustained the Commissioner's determination, finding an absence of any "indicium recognizing [PMSA's] controlling position" on the part of the Warriors and holding this to preclude acceptance of petitioner's contention that PMSA, rather than he, controlled the earning of the income in controversy. Pet. App. A12-A18.

The court of appeals, relying on *Johnson* v. *United States*, 698 F.2d 372 (9th Cir. 1982),[3] affirmed, hold-

---

[3] The Commissioner also assessed a deficiency against petitioner for 1978. Petitioner paid this deficiency and sued in the United States District Court for the Northern District of California for a refund. The district court entered summary judgment for the government in that action and the court of appeals affirmed (*Johnson* v. *United States*, 698 F.2d 372 (1982) (Pet. App. A19-A22)). The court of appeals held that petitioner was taxable on the entire amount paid by the teams (the Warriors and the Washington Bullets) to Interlit (PMSA's and EST's successor in interest). The result was based on the fact that petitioner, not PMSA or Interlit, controlled the earning of the income in question since, as a matter of law, the contractual relationship among the parties simply did not amount to a licensing or loan-out arrangement between PMSA and the teams. Taxpayer did not file a petition for a writ of certiorari in that case. Pet. App. A3, A19-A21.

ing that petitioner controlled the earning of the income in controversy because he, and not PMSA, had contracted with the Warriors (Pet. App. A2).

2. It is a basic principle of federal income taxation that income must be taxed to the one who controls its earning. *Lucas* v. *Earl*, 281 U.S. 111 (1930); *Commissioner* v. *Culbertson*, 337 U.S. 733 (1949); *United States* v. *Basye*, 410 U.S. 441 (1973). In *Lucas* v. *Earl*, *supra*, the "seminal precedent" in this area (*Basye*, 410 U.S. at 450), the taxpayer entered into a contract with his wife providing that any property, including income from future personal services, was to be owned jointly. The husband thereafter reported only half of the salary and fees he earned as an attorney. This Court held that the husband was responsible for the entire amount of earned income, stating that salaries must be taxed "to those who earned them" and that "the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it" (281 U.S. at 114-115). See also *Harrison* v. *Schaffner*, 312 U.S. 579 (1941). Accordingly, where the assignor/wage-earner retains control over the earning of compensation, any attempted shift in the incidence of taxation must be disregarded and the payments must be taxed to the wage-earner: "the fruits" cannot be "attributed to a different tree from that on which they grew" (281 U.S. at 115).

Of course, the incidence of taxation on income derived from personal services does not depend solely on a mechanical determination of who performed the services for which payment was made. For example, an employee whose services are controlled by the em-

ployer is taxable on his salary from the employer, not on the payments made from customers to the employer for the services. Thus, as the courts below recognized (Pet. App. A2, A15, A21), it is necessary to determine whether the individual taxpayer who performs the services is subject to the control of the employing entity in some meaningful sense, and whether the particular services which generate the compensation are performed pursuant to contract or control of the putative employer, as opposed to the individual taxpayer. *Vnuk* v. *Commissioner*, 621 F.2d 1318, 1320-1321 & n.5 (8th Cir. 1980). If, as in *Lucas* v. *Earl*, *supra*, the services are controlled and performed pursuant to a contract made by the individual taxpayer (even though the proceeds are assigned to another entity), the compensation constitutes income to the individual taxpayer.

In the instant case, the Tax Court, affirmed by the court of appeals, concluded that petitioner, and not PMSA or EST, earned and controlled the income at issue. That factual conclusion does not warrant review by this Court, and in any event is plainly correct. The employment contracts were executed solely between petitioner in his individual capacity and the Warriors; PMSA and its successors were in no way obligated to provide any services. The Warriors in fact refused to "license" petitioner from a third party and insisted on employing petitioner directly and personally.[4] Payments were made by the War-

[4] It is therefore somewhat misleading for petitioner to assert in his "Questions Presented For Review" (Pet. i) and subsequently in his petition (Pet. 13) that PMSA and its successors "licensed" petitioner's services to the Warriors. They did no such thing. Petitioner, in his individual capacity, signed contracts with the Warriors, and assigned the proceeds from

riors to EST only after petitioner assigned them to EST. Petitioner's execution of an assignment of contract rights under his Warriors contract itself demonstrates that petitioner regarded these funds as under his control to assign. Accordingly, this case presents no less obvious an anticipatory assignment of income than did *Lucas* v. *Earl*, *supra*.

3. Petitioner attempts to sidestep the anticipatory assignment of income principle by means of two purported distinctions.

a. First, petitioner contends (Pet. 6-11) that the anticipatory assignment of income principle applies only when the taxpayer has a "vested" and "unrestricted" claim to the income at the time he makes the assignment. This is a startling proposition when applied to personal service income, for it would effectively enable any individual to make anticipatory assignments of income, and be freed from tax thereon, merely because (as is usually the case) there is a possibility that he may not find work or may be discharged. For refutation of this proposition, we need look no further than *Lucas* v. *Earl*, *supra*. There, the assignment was of income to be derived from fees for future legal services; plainly, a lawyer has no "vested" or "unrestricted" claim to fees for services he has not yet performed, on behalf of clients he has not yet obtained.

None of the cases on which petitioner relies involved future payments for personal services yet to be performed. *Cold Metal Process Co.* v. *Commissioner*, 247 F.2d 864 (6th Cir. 1957), for example, involved a transfer of income producing property.

---

those contracts to PMSA and its successors. There was no contractual or licensing relation whatsoever between the Warriors and PMSA, EST, or Interlit.

And in *Estate of Cole* v. *Commissioner*, 42 T.C.M. (P-H) ¶ 73,074 (1973), the court was careful to distinguish between the "assignment of income which will be earned by the future personal efforts of a taxpayer," such as is involved in the instant case, and the assignment of a contract right, as was involved there.[5]

Petitioner's reliance on *Harrison* v. *Schaffner*, *supra*, is similarly misplaced. *Harrison* involved a taxpayer's assignment of a portion of trust income to her children and son-in-law. Whether the trust income was a "vested" or "unrestricted" right was not a factor in the decision.[6]

b. Second, petitioner contends (Pet. 11-13) that the courts below erred in relying on the fact that the personal service contracts entered into by the Warriors were with petitioner as an individual rather than with PMSA or its successors. This argument is without merit. The issue here is whether petitioner's earnings were controlled by him or by the assignee corporations. The facts indisputably show that all contracts were signed by petitioner in his *individual* capacity. *No* contractual or licensing relation existed between PMSA (or its successors) and the Warriors at any time; indeed, the Warriors

---

[5] *Wood Harmon Corp.* v. *United States*, 311 F.2d 918 (2d Cir. 1963), and *Commissioner* v. *Oates*, 207 F.2d 711 (7th Cir. 1953), are distinguishable on similar grounds.

[6] Nor does petitioner glean support from *Teschner* v. *Commissioner*, 38 T.C. 1003 (1962). In light of this Court's decision in *United States* v. *Basye*, *supra* (distinguishing between consensual deflections of income and deflections imposed by law), *Teschner* can stand for no more than the proposition that where a factor independent of the taxpayer irrevocably prevents his ever receiving the income in issue, anticipatory assignment of income principles may not apply.

steadfastly refused to enter such a relation. PMSA and its successors were mere assignees of income generated as a result of petitioner's own contracts. Under settled principles of law (see pages 4-5, *supra*), this is dispositive.

Petitioner's reliance (Pet. 12) on *Foglesong* v. *Commissioner*, 621 F.2d 865 (7th Cir. 1980), is misplaced. In *Foglesong*, "the Corporation and not the taxpayer [was] the party to the contracts under which services [were] performed" (*id.* at 868). Here, the compensation paid by the Warriors was paid pursuant to personal service contracts between petitioner and the Warriors—not between PMSA (or its successors) and the Warriors.

Petitioner also relies (Pet. 12-13) on *R. & L., Inc.* v. *Commissioner*, 84 F.2d 721 (5th Cir. 1936). There, however, the issue before the court was whether the accumulated and undistributed income of a corporation was subject to surcharge. The court's comments on the proper treatment of commissions earned in part by an individual and assigned to the corporation were dicta. Even so, the court observed that "in strictness," the individual should have reported the commissions as income to himself (84 F.2d at 722 (citing *Lucas* v. *Earl*, *supra*)). To the extent that *R. & L., Inc.* pertains to the questions here, it is therefore consistent with the decision below.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
*Solicitor General*

SEPTEMBER 1984

☆ U. S. GOVERNMENT PRINTING OFFICE: 1984 421923 10034